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Supreme Court of the United States

October Term, 1939

No. 1040 101

HENRY F. DU PONT, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PERCY W. PHILLIPS,
Attorney for Petitioner.

May, 1940.

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CASES CITED

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COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Henry F. du Pont, petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on February 28, 1940, affirming the decision of the United States Board of Tax Appeals.

Opinions Below

The opinion of the Board of Tax Appeals (R. 209) is reported in 38 B.T.A. 1317. The opinion of the Cir-

cuit Court of Appeals (R. 259) is reported in 110 F. (2d) 641.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered February 28, 1940 (R. 259). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented

Whether a gain derived upon the sale of 62,500 shares of the common stock of Du Pont Company, or upon the sale of 40,500 of such shares, was gain from the sale of capital assets or was gain from a short sale.

Statute Involved

Revenue Act of 1932, c. 209, 47 Stat. 169 (Public No. 154; Seventy-second Congress):

> SEC. 101. CAPITAL NET GAINS AND LOSSES.
>
> (a) *Tax in Case of Capital Net Gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total

tax shall be this amount plus $12\frac{1}{2}$ per centum of the capital net gain.

* * * * *

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

* * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years * * *.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

(s) *Limitation on Stock Losses—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

Statement

Despite the voluminous documentary record, the facts are very simple.

The petitioner, in 1932, was heavily indebted to the Bankers Trust Company in New York which demanded that he either deposit more collateral or reduce his debt. Included in the collateral for said debt were 62,500 shares of the common stock of E. I. du Pont de Nemours & Company (hereafter referred to as "Du Pont Company"). The petitioner made arrangements

with the Trust Company whereunder he would be allowed to withdraw said 62,500 shares of Du Pont Company common stock from his collateral, if he reduced his loan with the Trust Company by $2,000,000. [Stipulation, ¶¶ 11, 12, 13, 14; Exs. N to Q; R. 25, 26, 27, 179 to 183]. Said stock had been owned by the petitioner for more than two years. [Stipulation, ¶¶ 39, 47; Ex. A2 of Ex. C; R. 41, 45, 77.]

Petitioner entered into a contract with Christiana Securities Company whereby he agreed to sell it 62,500 shares of Du Pont Company common stock for $2,000,000, and thus acquire the money to pay to the bank. Christiana Securities Company arranged with J. P. Morgan & Company in New York to receive the stock for it and pay $2,000,000. [Stipulation, ¶¶ 15 to 18; Ex. U; R. 27, 28, 187.]

Petitioner requested his broker, Ellis, associated with the brokerage firm of Laird, Bissell & Meeds, who had offices in Wilmington and in New York, to carry out the details of the transaction. Ellis had the New York office of the brokers pay $2,000,000 to the Bankers Trust Company of New York on April 21, 1932, for the account of the petitioner, whereupon said Bankers Trust Company delivered to the brokers 62,500 shares of petitioner's stock of Du Pont Company. On the same day this stock was transferred from the name of petitioner to the name of the brokers, whereupon the New York office of said brokers delivered 62,500 shares of the stock of Du Pont Company to J. P. Morgan & Company, for the account of Christiana Securities Company, receiving payment of $2,000,000 therefor. Of the stock so delivered, 40,500 shares were out of

the certificates of the stock of the petitioner previously received by the brokers on the same day from Bankers Trust Company. [Stipulation, ¶¶ 19, 20; Ex. S; R. 28, 29, 30, 185].

Ellis had instructed the New York office of the brokerage firm that the stock delivered to Morgan & Company should not be stock of the petitioner, but should be borrowed stock. The instructions of Ellis with respect to delivery of borrowed stock were not followed, except with respect to 22,000 shares which were borrowed by the brokers and delivered to Morgan & Company. As to 40,500 shares, deliveries were made by the brokers of the stock which the petitioner had previously owned for a period of more than two years and which had been held in the Bankers Trust Company account. The transaction was recorded upon the accounts and books of the brokers as a short sale of borrowed stock by petitioner to Christiana Securities Company and a delivery by petitioner to the brokers of the "long" stock from Bankers Trust Company. The fact that the "long" stock of the petitioner was used in making delivery was either not known or was ignored in the accounting procedure.

The Commissioner of Internal Revenue and the Board of Tax Appeals held that the profit from the sale of all of said 62,500 shares of the stock of Du Pont Company was realized upon a short sale of stock, and was not realized upon the sale of the stock which petitioner had held for more than two years. The decision of the Board of Tax Appeals was affirmed by the Circuit Court of Appeals. Said decisions were based upon the intention of Ellis and upon the entries made upon

the books of account and ignored the actual facts of the transaction which took place. The rate of tax upon gains from the sale of capital assets held for more than two years is less than the tax upon the gain from short sales of stock.

Specification of Errors to be Urged

The Circuit Court of Appeals erred:

1. In holding that the gain realized by the petitioner from the sale of 40,500 shares of the stock of Du Pont Company was not subject to tax as capital gain, but was subject to tax at normal and surtax rates.

2. In the alternative to (1) above, in holding that the gain realized by the petitioner from the sale of 62,500 shares of the stock of Du Pont Company was not subject to tax as capital gain, but was subject to tax at normal and surtax rates.

Reasons for Granting the Writ

Section 101 of the Revenue Act of 1932, *supra*, provides for the taxation of gain from the sale of capital assets at special rates of tax. Section 23 (s) of that Act, *supra*, provides that such special rates shall not apply to gains from short sales of stocks. In this case the rate of tax depended upon whether or not there had been a short sale which, in turn, depended upon whether or not the sale was completed by delivery of borrowed stock or by delivery of stock owned by the petitioner. The record showed that on the books of account of the broker and of the petitioner the transaction was recorded as a short sale, but also showed

that the actual transaction was not a short sale. Of 62,500 shares sold and delivered, 40,500 shares delivered to the purchaser were from the long stock which had been owned by the petitioner for more than two years, and only 22,000 shares were borrowed. In determining that there had been a short sale of 62,500 shares, the Court below gave effect to the intention of the broker to effect a short sale and to the bookkeeping entries recording a short sale, and failed to give effect to the actual transaction. Such decision is in conflict with decisions of this Court, and with certain decisions of the Circuit Courts, announcing the principle that neither intention nor bookkeeping entries can prevail over the actual transaction in determining what shares of stock are involved in a sale.

In a case involving the same principle, *Davidson* v. *Commissioner*, 305 U. S. 44, this Court held that tax liability on the sale of stock was governed by the stock delivered and not by the intention or instructions of the owner to deliver other stock. In that case the owner had instructed his bank to deliver certain certificates of stock upon a sale. The bank delivered other certificates which had a different basis for tax liability. The Court held that the tax liability was to be determined by the stock actually delivered, regardless of intent or instructions.

That case is on all fours with the present case. Although cited in briefs, it was ignored by the Circuit Court in its decision.

To the same effect is *Doyle* v. *Mitchell Brothers*, 247 U. S. 179.

This instant decision is also in conflict with *Ruml* v. *Commissioner*, 83 F. (2d) 257 (CCA-2); *Huntington National Bank* v. *Commissioner*, 90 F. (2d) 876 (CCA-6); *Commissioner* v. *Dashiell*, 100 F. (2d) 625 (CCA-7).

In deciding the instant case, the Circuit Court treated the issue as one of first impression. It cited no authorities for its decision. It ignored the decisions of this Court in *Davidson* v. *Commissioner*, *supra*, and *Doyle* v. *Mitchell Brothers Co.* It ignored the decisions of other circuits in somewhat similar circumstances.

In similar circumstances, this Court granted certiorari. *Deputy* v. *du Pont*, 308 U. S. 488, where this Court said:

> "We granted certiorari because of the asserted inconsistency of that ruling [decision of Third Circuit Court of Appeals] with *Welch* v. *Helvering*, 290 U. S. 111, and with *Burnet* v. *Clark*, 287 U. S. 410."

It is respectfully submitted that this petition should be granted.

PERCY W. PHILLIPS,
Attorney for Petitioner.

May, 1940.

IN THE

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No. 101

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GUY T. HELVERING, *Commissioner of Internal Revenue*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Reply Brief for Petitioner

IN THE

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Reply Brief for the Petitioner

This case was submitted upon a stipulation of facts. That stipulation was adopted by the Board of Tax Appeals as its finding of facts. Consequently, the questions involved are questions of law arising from undisputed facts.

The bulk of the argument in the brief of the respondent is directed to showing that the parties to the transaction intended that a short sale should be made and that the transaction was recorded on the books of account as a short sale. This is conceded and was conceded below. The application for certiorari is based upon the ground that intention and book-

keeping cannot control over the actual facts;[1] that the stipulated facts in this case show that there was in fact no short sale but a sale and delivery of stock which had been owned by the petitioner for more than two years, and that in following the intention and bookkeeping, and in giving no effect whatever to the actual facts of the transaction, the Circuit Court refused to follow decisions of this Court and decisions of other circuits. The Circuit Court did not even mention such decisions, although they were brought to its attention. In such circumstances, this Court has granted certiorari. *du Pont* v. *Commissioner*, 308 U. S. 488.

The facts with respect to the transaction are set out in ¶ 20 of the stipulation [R. 28, 29]:

> "* * * the New York Office of Laird, Bissell & Meeds received from the Bankers Trust Company through the Stock Clearing Corporation 62,500 shares of common stock of E. I. du Pont de Nemours & Co. consisting of stock certificates numbered E-246118 for 2,500 shares, E-9197 for 30,000 shares, E-90414 for 10,000 shares, E-147003 for 10,000 shares and E-147004 for 10,000 shares, all registered in the name of the petitioner, and accompanied by blank powers of attorney for transfer properly endorsed by the petitioner. * * * The certificates which Laird, Bissell & Meeds received from the Bankers Trust Company were delivered to the transfer agent of E. I. du Pont de Nemours & Co. on April 21, 1932, and new stock certificates were received by Laird, Bissell & Meeds from the transfer agent the same day numbered 102198 to 102822, inclusive, for

[1] *Davidson* v. *Commissioner*, 305 U. S. 44; *Doyle* v. *Mitchell Bros.*, 247 U. S. 179.

100 shares each, all in the name of Laird, Bissell & Meeds.

"On the same day, namely, April 21, 1932, Laird, Bissell & Meeds delivered to J. P. Morgan & Company 622 stock certificates for 100 shares each, and 11 stock certificates aggregating 300 shares, of the common stock of E. I. du Pont de Nemours & Co., * * *. Of the stock certificates delivered by Laird, Bissell & Meeds to J. P. Morgan & Company on April 21, 1932, 405 of such certificates, representing 40,500 shares of common stock of E. I. du Pont de Nemours & Co., were part of the series of certificates numbered 102198 to 102822, inclusive, for 100 shares each, previously on the same day issued in the name of Laird, Bissell & Meeds by the transfer agent of E. I. du Pont de Nemours & Co. in exchange for certificates numbered E-246118, E-9197, E-90414, E-147003 and E-147004 as above set forth in this paragraph."

Exhibit A-2 of Exhibit C [R. 77] shows such stock to have been acquired by the petitioner more than two years prior to the sale.

The quotations above from the stipulation are the facts with respect to the identity of the stock delivered on the sale. The balance of the stipulation relates either to other transactions which were admittedly short sales and are no longer in dispute,[2] or to the bookkeeping used in recording this transaction. The entire point of the case, which seems to have been lost upon the Circuit Court and in the respondent's brief in opposition, is that the stipulated facts show that what was intended to be, and was recorded as, a short

[2] Such other transactions fall within *du Pont* v. *Commissioner*, 98 F. (2d) 459, certiorari denied, 305 U. S. 631.

sale was actually executed in such manner as to make the transaction a sale by petitioner of his long stock.

In *Davidson* v. *Commissioner*, *supra*, the taxpayer had sold stock and had instructed his bank to deliver certain certificates upon such sale. The bank erroneously delivered other certificates which had a different basis for tax liability. This Court held that the tax liability was to be determined upon the basis of the actual delivery and that neither intent nor instructions could control.

Here the brokers had been instructed not to deliver the stock of the petitioner, but to make delivery out of borrowed stock. Had these instructions been followed, the case would have been identical with *du Pont* v. *Commissioner*, 98 F. (2d) 459, certiorari denied, 305 U. S. 631, upon which the respondent relies. But, as in the *Davidson* case, those instructions were not followed. Delivery, to the extent of 40,200 shares, was made with the stock of the petitioner.

Taxation is based upon actualities. It is a poor rule which does not work both ways. If taxpayers are to be charged with a tax resulting from a mistake of an agent, they should not be penalized when another mistake results in a lower tax than would have resulted had instructions been followed. The Circuit Court decision is directly contrary to the decision in the *Davidson* case and many similar Circuit Court cases.

Respondent states that this Court has already denied certiorari under similar facts, citing *du Pont* v. *Commissioner*, 98 F. (2d) 459, certiorari denied, 305 U. S. 631. The respondent is mistaken in stating that the

facts were similar. In that case it appeared that when sales were made, borrowed stock was delivered. The taxpayer there did not part with his stockholdings until months after the short sale had been consummated by delivery of borrowed stock, and the question was whether the act of the petitioner in covering the short sales with the long stock had changed the nature of a transaction which was admittedly executed and carried out as a short sale.

Here there is no such situation. The petitioner had owned stock of Du Pont Company which was held by Bankers Trust Company as collateral. The sale to Christiana Securities Company was made by delivering 40,200 shares of this stock. Although first transferred out of the name of the petitioner and into the name of the brokers, the delivery was made with petitioner's stock and not, as in the case cited, with stock borrowed by the broker from others.

Respondent urges that because petitioner's stock was first put into the name of the brokers, it was no longer the stock of petitioner and that delivery was made with stock owned by the brokers.[3] But what title did the brokers have to deliver? They must have acquired that title either by

(a) buying the stock from the petitioner, or
(b) borrowing the stock from petitioner.

If they bought it from petitioner, then there was a sale by petitioner to the brokers of his long stock and

[3] Although differing on the facts, the principles followed in the decision below clash with the principles governing the decisions in *Northwest Utilities Corp.* v. *Helvering* (C.C.A. 8th), 67 Fed. (2d) 619; *Taylor Oil & Gas Co.* v. *Commissioner* (C.C.A. 5th), 47 Fed. (2d) 108; and *Boggs-Burnam & Co.*, 26 B.T.A. 988, affirmed per curiam (C.C.A. 6th) 71 Fed. (2d) 999.

the gain realized was capital gain. If the brokers borrowed it from the petitioner, then

(c) the brokers made the sale to Christiana acting as principals, in which case the petitioner made no sale until August when the brokers acquired his long stock to cover their borrowing, or

(d) if the brokers were acting as agents, they immediately reloaned to the petitioner the stock which they had borrowed from the petitioner. In other words, the agent borrowed stock from the principal for the purpose of loaning such stock to the principal, to be used by the agent in consummating a sale made by the principal. Or, to put it more briefly, the petitioner must have borrowed his own stock to complete the sale which he had negotiated.

If the principles laid down in the decision of this case are sound, there is no reason why anyone should ever pay a tax upon the profit from the sale of any security. Assume that individual "Z" owns stock of Corporation X which had cost Z $25,000 but which today can be sold for $250,000. Z arranges the sale, but before making delivery Z transfers the stock to a broker. The broker enters the stock in a long account. The broker causes the stock to be transferred to his name, makes delivery to the purchaser with such stock, receives the purchase price of $250,000, records Z's account as short for the same amount of stock and credits Z with $250,000, the proceeds of the so-called short sale. The purchaser has the stock, Z has the sales price, and Z is recorded on the books of the broker as both long and short of the same stock. Obviously the broker has no gain or loss to report as he has sold

at the same price at which he purchased. The respondent and the Circuit Court say that Z would have no gain or loss until Z caused the long and short accounts to be offset. But there is no reason why Z should ever cause this to be done, as the accounts are in perfect balance and offset each other. There never would be a tax on the transaction. The result is ridiculous. Clearly, Z's stock has been sold and delivered, the stock is no longer his, he has received the proceeds, and, under the decision of this and other courts, he cannot postpone or entirely escape the tax by the device of having his broker record the transaction as a short sale of his own stock. But, if the instant case is a proper interpretation of the law and the decisions of this Court, Z has no tax to pay although his own stock is the only stock involved in the transaction.

It is not contended that where there is a true short sale of stock and the taxpayer continues to own an equal amount of the same stock, the same rule would apply. In such a case the taxpayer has all the rights of an owner in the long stock, including the right to vote it and receive dividends. He has an obligation to deliver stock borrowed by his broker from a third person. Sooner or later the transaction will have to be closed, for the third party will demand delivery. But where, as in the instant case, the petitioner's own stock is used to make the delivery, there is no such situation. Could the petitioner have voted the stock which had been delivered in the instant case? Would the Du Pont Company pay him a dividend on it? Obviously not. The only person entitled to vote the stock was the purchaser and the person who had lost

the right to vote was the petitioner. The person who would receive the dividends was the purchaser. All rights to the stock had passed from the petitioner to the purchaser and the petitioner had the proceeds of the sale.

This Court should grant the petition for certiorari, and remand the case to the Circuit Court with instructions to render a decision consistent with the decision of this Court in *Davidson* v. *Commissioner, supra, Doyle* v. *Mitchell Bros., supra,* and the decisions of the circuit courts which have followed those decisions. See *Deputy* v. *du Pont*, 308 U. S. 488, quoted at page 8 of the petition for certiorari.

Respectfully submitted,

PERCY W. PHILLIPS,
Attorney for Petitioner.

IVINS, PHILLIPS, GRAVES & BARKER,
Of Counsel.

June, 1940.

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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 101

HENRY F. DU PONT, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 209) is reported in 38 B. T. A. 1317. The opinion of the Circuit Court of Appeals (R. 259) is reported in 110 F. (2d) 641.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 28, 1940 (R. 266). The petition for a writ of certiorari was filed on May 25, 1940. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the sale of certain stock under the circumstances of this case was a short sale within the meaning of Section 23 (s) of the Revenue Act of 1932.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (r) Limitation on Stock Losses.—
>
> * * * * *
>
> (s) *Same—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.
>
> * * * * *

STATEMENT

The facts, which were stipulated by the parties and adopted by the Board as its findings of fact (R. 210–221), may be summarized as follows:

The taxpayer is a resident of Winterthur, Delaware. During 1932 he was not engaged in the

trade or business of buying and selling securities, nor was he connected with any stock exchange or brokerage firm. He was, however, a holder of substantial blocks of stock of the duPont Company, General Motors Corporation, and other corporations. He purchased and sold large quantities of stock during 1932. (R. 213.)

Raymond W. Ellis was employed as a customers' man by Laird, Bissell & Meeds, a firm of stockbrokers and members of the New York Stock Exchange, with offices located in Wilmington and New York City. Ellis had a clientele of his own and maintained an office separate from that of Laird, Bissell & Meeds but located in the same building. (R. 213–214.)

The taxpayer was accustomed during the year 1932 and for several years prior thereto to rely upon the advice of Ellis as to all matters concerning the purchase and sale of securities. The taxpayer was not familiar with the provisions of the federal income-tax laws, but Ellis was considered an expert in that field. It was taxpayer's custom in buying and selling securities to advise Ellis of the transactions he wished to make. Taxpayer was not accustomed to instruct Ellis as to the manner in which purchases or sales should be made, nor as to which one of his accounts purchases or sales should be made for, but relied upon Ellis to handle such transactions in whatever way would be most advantageous to taxpayer from the standpoint of income or other taxes. In return for Ellis' serv-

ices in this connection taxpayer during 1932 placed all of his orders for the purchase and sale of securities through Ellis and also paid him a yearly fee of $1,000. The taxpayer's federal income-tax return for 1932 was prepared for the taxpayer by Ellis. (R. 214.)

The taxpayer maintained five accounts during the calendar year 1932 with the Wilmington office of Laird, Bissell & Meeds. These accounts were designated respectively "H. F. duPont," "H. F. duPont Special," "H. F. duPont Short," "H. F. duPont Short No. 2," and "H. F. duPont Special Short." (R. 214.)

Orders for sales of stocks in 1932 were ordinarily placed with the Wilmington office of Laird, Bissell & Meeds by Ellis pursuant to oral instructions from the taxpayer and then sent by telephone to Laird, Bissell & Meeds' New York office. The sales were then made by the brokers on the floor of the New York Stock Exchange in the ordinary course of business. Deliveries to purchasers were made on the following full business day out of shares belonging to Laird, Bissell & Meeds or their customers, or from shares borrowed by them from other brokers. The proceeds of the sales were credited to taxpayer's respective accounts as directed by Ellis. (R. 214–215.)

As of April 1, 1932, the taxpayer was indebted to the Bankers Trust Company of New York in the amount of $4,000,000. The indebtedness was se-

cured by collateral which included 90,000 shares of the common stock of the duPont Company. The Bankers Trust Company requested the taxpayer to deposit additional collateral or else to reduce the indebtedness. The Bankers Trust Company was willing to release 62,500 shares of the duPont stock upon the payment to it of $2,000,000 in reduction of the taxpayer's indebtedness. He contracted to sell to the Christiana Securities Company 62,500 shares of duPont common stock at that price. The Christiana Securities Company made an arrangement with J. P. Morgan & Company of New York to lend it $2,000,000 upon the security of 62,500 shares of duPont stock. (R. 215.)

On or about April 20, 1932, the taxpayer advised Ellis of the arrangements which he had made with the Bankers Trust Company and the Christiana Securities Company and requested Ellis "to handle the matter" for taxpayer through Laird, Bissell & Meeds. On the same day Ellis wrote and transmitted to the New York office of Laird, Bissell & Meeds a memorandum of instructions reading as follows (R. 215–216):

> April 20, 1932.
>
> Memorandum to: Mr. John Ross
> From: R. W. Ellis
>
> You are to pay to the Bankers Trust Company two million dollars ($2,000,000), receiving sixty-two thousand five hundred (62,500) shares duPont Common in the name of H. F. duPont. You are to place in

the name of Laird, Bissell & Meeds the sixty-two thousand five hundred (62,500) shares duPont Common.

We will make delivery in Wilmington of sixty-two thousand five hundred (62,500) shares duPont Common, preferably in stock other than certificates which you receive from the Bankers Trust Company. In fact, to eliminate any possible chance of being taxed on the sale, we must see to it that none of the Bankers Trust certificates are used in making this delivery.

[Signed] R. W. Ellis

On April 21, 1932, Ellis, using the form of buy and sell orders used by Laird, Bissell & Meeds for investment purchases and sales for its own account (as distinguished from the form of buy and sell orders for the accounts of customers), made out a buy order showing that Laird, Bissell & Meeds purchased 62,500 shares of duPont Company common stock for $2,000,000 from "H. F. duPont Short No. 2" account, and a sell order showing that Laird, Bissell & Meeds sold for $2,000,000 to the Christiana Securities Company 62,500 shares of duPont common stock. (R. 216.)

Upon receipt of the memorandum of instructions from Ellis, the New York office of Laird, Bissell & Meeds received from the Bankers Trust Company through the Stock Clearing Corporation 62,500 shares of common stock of the duPont Company. The certificates were all registered in the name of the taxpayer and were accompanied by blank pow-

ers of attorney for transfer properly endorsed by the taxpayer. At the same time the Bankers Trust Company billed Laird, Bissell & Meeds through the Stock Clearing Corporation for $2,000,000 against this delivery of 62,500 shares of the common stock of the duPont Company. Payment was made by Laird, Bissell & Meeds to the Bankers Trust Company through the Stock Clearing Corporation in their daily settlement check. The certificates which Laird, Bissell & Meeds received from the Bankers Trust Company were delivered to the transfer agent of the duPont Company on April 21, 1932, and new stock certificates were received by Laird, Bissell & Meeds from the transfer agent the same day, all in the name of Laird, Bissell & Meeds. (R. 216–217.)

On the same day, April 21, 1932, Laird, Bissell & Meeds delivered to J. P. Morgan & Company stock certificates for 62,500 shares of the common stock of the duPont Company and received from J. P. Morgan & Company a check drawn to the order of Laird, Bissell & Meeds in the amount of $2,000,000. Of the stock certificates delivered to J. P. Morgan & Company, certificates representing 40,500 shares of the common stock of the duPont Company were part of the certificates previously issued on the same day in the name of Laird, Bissell & Meeds by the transfer agent of the duPont Company. The remaining certificates, representing 22,000 shares of the common stock of the

duPont Company, were either in the name of Laird, Bissell & Meeds or in street names and were not a part of the series which Laird, Bissell & Meeds had on the same day received from the transfer agent. (R. 217.)

The accounting records of Laird, Bissell & Meeds show 62,500 shares of duPont Company common stock received from the New York office for the "H. F. duPont Special" account (a long account) at a charge of $2,000,000. They also show 62,500 shares of the duPont stock delivered to the New York office for the Christiana Securities Company account at a charge of $2,000,000. (R. 217.)

On April 21, 1932, Laird, Bissell & Meeds delivered confirmation notices to the taxpayer notifying him that his "H. F. duPont Short No. 2" account was credited in the sum of $1,999,250 as the proceeds of the sale of 62,500 shares of duPont Company common stock, and that his "H. F. duPont Special" account was charged in the sum of $2,000,000 against receipt of 62,500 shares of the same stock. Upon receipt of these confirmation notices entries were made on taxpayer's books in accordance therewith as shown in taxpayer's ledger accounts entitled "Laird Bissell and Meeds—H. F. duPont Short Account #2" and "Laird Bissell and Meeds—H. F. duPont Special Account." (R. 217–218.)

The investment ledger of Laird, Bissell & Meeds reflects purchases and sales by Laird, Bissell &

Meeds for its own account as principal. On April 21, 1932, an entry was made in the Laird, Bissell & Meeds investment ledger account entitled "E. I. duPont de Nemours & Co. Common Stock," showing a purchase on that date from "H. F. duPont Short No. 2" account of 62,500 shares for $2,000,000 and a sale on that date to the Christiana Securities Company of 62,500 shares at a price of $2,000,000. The sale by taxpayer of 62,500 shares of duPont Company common stock is recorded in the ledger account entitled "H. F. duPont Short No. 2" under date of April 22, 1932. The receipt of 62,500 shares is recorded in the account entitled "H. F. duPont Special" under date of April 21, 1932. (R. 218.)

About four months later, on August 19, 1932, taxpayer through Ellis instructed Laird, Bissell & Meeds to transfer the entire balance of 62,500 shares of common stock of the duPont Company in his "H. F. duPont Special" account to his "H. F. duPont" or "regular" account. The brokers were then to transfer the 62,500 shares from this long account to his "H. F. duPont Short No. 2" account, to be applied against the sale in that account on April 21, 1932, of 62,500 shares of common stock of the duPont Company. These instructions were executed by the brokers on the same day and the sale of 62,500 shares of common stock of the duPont Company in the "H. F. duPont Short No. 2" account was closed by such transaction. (R. 218.)

A dividend at the rate of 75 cents a share was declared on the duPont Company common stock, payable June 15, 1932, to stockholders of record of May 25, 1932. On June 15, 1932, Laird, Bissell & Meeds charged the "H. F. duPont Short No. 2" account $46,875, representing the dividend paid on 62,500 shares. On the same day Laird, Bissell & Meeds credited the "H. F. duPont Special" account with a corresponding amount. (R. 218–219.)

For the purpose of computing the margin for carrying the accounts of the taxpayer during the year 1932, Laird, Bissell & Meeds considered his five accounts as one consolidated account (R. 219).

During all of the year 1932 Laird, Bissell & Meeds maintained daily records showing the long and short positions of its customers. These records consisted of large sheets of paper, one side of which was designated with the name of the stock involved and the word "long" and the other side was captioned with the name of the stock and the word "short." The names of the customers were listed alphabetically on each side of these sheets with the number of shares long or short at the close of the business day covered by each sheet. The sale of the 62,500 shares of common stock of the duPont Company, shown in the "H. F. duPont Short No. 2" account, was listed on the position record of Laird Bissell & Meeds as a short sale; the entry bore the penciled word "offset," which was intended to show that the taxpayer had long positions equal to

or in excess of his short positions on the days in question. The sale of the 62,500 shares of common stock of the duPont Company was not reported by Laird, Bissell & Meeds to the New York Stock Exchange in its reports of overnight short positions required under the rule of the committee on business conduct promulgated April 8, 1932. (R. 220–221.)

The Board of Tax Appeals held that there was a valid short sale under the circumstances of this case, but three members of the Board dissented on the ground that the taxpayer intended and contracted to sell specific shares of stock to the Christiana Company. The Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals.

ARGUMENT

The transaction which the taxpayer might have accomplished was simple: the sale of 62,500 shares of the pledged duPont stock to the Christiana Company for $2,000,000 and a corresponding reduction of his indebtedness to the Bankers Trust Company. Instead, through his agent, he chose a considerably more intricate series of transactions: (1) he obtained a loan of $2,000,000 from his brokers; (2) this was paid to the Bankers Trust Company in reduction of his indebtedness; (3) the brokers received 62,500 shares of duPont common from Bankers Trust, to be held as collateral for this loan; (4) the taxpayer's long account was credited with 62,500 shares; (5) the brokers obtained new certifi-

cates in their own name; (6) the taxpayer sold 62,500 shares short; (7) the brokers on behalf of the taxpayer sold 62,500 shares to the agent of the Christiana Company, delivering in part the certificates obtained from the transfer agent on surrender of those received from Bankers Trust Company and in part other certificates; and (8) the agent of the Christiana Company paid the brokers $2,000,000 with which they discharged the debt of the taxpayer. At the close of April 21, 1932, the taxpayer thus had obtained the release of 62,500 shares from the Bankers Trust Company, which had been credited by his brokers to his long account; his brokers had delivered 62,500 shares to the Christiana Company and he had sold 62,500 shares from his short account.

The court below (R. 263–264) advanced the probable explanation of this devious substitute for a simple transaction. The taxpayer hoped that he could cover the short account by delivery from the long account, from other duPont stock held by the taxpayer, or by stock purchased on the open market, as later price movements would indicate the possibility of tax savings.[1] Whether or not this

[1] One supposes that the taxpayer would then have argued that gain or loss from the short sale was to be based upon the cost of the certificates actually delivered, and that the transactions by which Bankers Trust Company surrendered 62,500 shares and Christiana Company purchased 62,500 shares were those of his brokers, and not a sale of stock by him.

scheme would have worked, the taxpayer's agent was careful to specify that none of the certificates obtained from Bankers Trust Company should be delivered to Christiana Company. The plan had more of subtlety than foresight, for Section 23 (s) was added by the Revenue Act of 1932, enacted about six weeks after these transactions were executed,[2] with the result that the taxpayer's profit, realized through a short sale, must be taxed as ordinary income rather than as a capital gain.

The taxpayer concedes that his agent intended to make a short sale and that the bookkeeping entries of his broker recorded a short sale (Pet. 6–7), but contends that the brokers' records are false and that there was not in fact a short sale. The Board of Tax Appeals and the court below correctly determined that Ellis made a valid short sale of 62,500 shares of duPont common stock for the taxpayer. The taxpayer treated it as a short sale and covered the sale with long stock in August 1932. Moreover, the short sale of 62,500 shares of duPont common on April 21, charged to the "Short No. 2" account, was carefully kept a wholly separate and distinct transaction from the transfer of 62,500 shares from the Bankers Trust Company to his long account.

It may be pointed out also that the taxpayer did not buy 62,500 shares of duPont common stock on

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[2] The provision appeared as Section 23 (u) of the bill as introduced in the House on March 7, 1932.

April 21, 1932. He merely arranged with Bankers Trust Company to release that amount of duPont stock as collateral for his loan and instructed his broker to deposit that amount of stock in one of his long brokerage accounts. It was not a purchase; it was merely a transfer. He reduced his loan with the Bankers Trust Company by $2,000,000 and obtained 62,500 shares of duPont common stock which was immediately deposited with his broker as collateral for a loan in the same amount. When the taxpayer deposited the stock in his margin account, it was immediately turned over to a transfer agent who issued new certificates in the name of his broker and from that time the taxpayer had merely a claim upon unidentifiable certificates.

The fact that 405 certificates delivered by the taxpayer's brokers to Christiana's agent represented 40,500 shares which were issued by the transfer agent of the duPont Company in exchange for the certificates that Laird, Bissell & Meeds obtained from the Bankers Trust Company has no material significance. The certificates delivered to Christiana's agent were not the same certificates which Laird, Bissell & Meeds received from the Bankers Trust Company, but were in the name of Laird, Bissell & Meeds or in street names, while the certificates surrendered by the Bankers Trust Company were in the taxpayer's name.

There is no conflict with *Davidson* v. *Commissioner,* 305 U. S. 44, or with *Doyle* v. *Mitchell*

Brothers Co., 247 U. S. 179, and there has been no departure from the principle that conclusive effect should not be given to the intention of the parties or to bookkeeping entries. The certificates acquired from the Bankers Trust Company were not delivered to the Christiana Company, but instead certificates in the name of Laird, Bissel & Meeds, or in street names, were delivered. The taxpayer intended to, and did make a short sale, which was covered by the transfer of shares credited to his long account. The facts coincide precisely with both the intention of the parties and the bookkeeping entries.

Ruml v. *Commissioner,* 83 F. (2d) 257 (C. C. A. 2d), *Huntington Nat. Bank* v. *Commissioner,* 90 F. (2d) 876 (C. C. A. 6th), and *Commissioner* v. *Dashiell,* 100 F. (2d) 625 (C. C. A. 7th), merely hold that the taxpayer's intention to make a long sale must control even though his broker delivered before receiving the actual certificates. Here there was no such intention.

This Court has already denied certiorari in a case which is similar on its facts, and in which the question was whether selling "against the box" constitutes a short sale. *DuPont* v. *Commissioner,* 98 F. (2d) 459 (C. C. A. 3d), certiorari denied, 305 U. S. 631.

CONCLUSION

The decision of the court below is correct. There is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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